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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-337

CHESTER C. DAVIS, *Petitioner,*

v.

UNITED STATES OF AMERICA, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

CHARLES ALAN WRIGHT
2500 Red River
Austin, Texas 78712

MOSES LASKY
BROBECK, PHLEGER & HARRISON
111 Sutter Street
San Francisco, California 94104

E. BARRETT PRETTYMAN, JR.
SHERWIN J. MARKMAN
JOSEPH M. HASSETT
HOGAN & HARTSON
815 Connecticut Avenue, N.W.
Washington, D.C. 20006

MAXWELL E. COX
DAVIS & COX
One State Street Plaza
New York, New York 10004

Attorneys for Petitioner

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Petitioner Chester C. Davis prays that a writ of certiorari issue to review the opinions and judgment of the United States Court of Appeals for the Ninth Circuit, entered on May 7 and July 8, 1976, that reversed an order of the United States District Court for the District of Nevada dismissing the indictment herein for failure to state an offense.

OPINIONS BELOW

The opinion of the Court of Appeals is not yet officially reported. It is unofficially reported at [1975-76 Transfer Binder] CCH Fed.Sec.L.Rep. ¶95,560, and is set forth at page 27a of the separately-bound Appendix. The order of the Court of Appeals denying the petition for rehearing and "explaining and clarifying" its earlier opinion is set forth at page 58a of the Ap-

pendix. The order of the District Court is set forth at page 19a of the Appendix.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on May 7, 1976. A timely petition for rehearing was filed on May 14, 1976, and denied on July 8, 1976. On July 28, 1976, Mr. Chief Justice Burger entered an order extending the time for filing this petition to and including September 6, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Consistent with Fifth and Sixth Amendment rights, may an appellate court uphold an indictment alleging a violation of the Securities Exchange Act of 1934 (the "Exchange Act") not by reference to any specific statutory provision nor to a specific rule or regulation but by declaring the charged conduct to be a crime based on the purpose of the Exchange Act as it perceives that purpose?

2. Must an indictment that purports to charge a violation of Rule 10b-5 of the Securities and Exchange Commission (the "Commission") allege that the defendant acted with a specific intent to deceive or defraud someone?

3. May Rule 10b-5 be construed to create an offense of trading manipulation that omits elements Congress specifically included in the definition of the offense of trading manipulation contained in Section 9(a)(2) of the Exchange Act?

4. Is it a crime to sell stock, or induce others to sell stock, on a national securities exchange, for the purpose of depressing the price of that stock even though the sales are real, not fictitious, and the stock was not sold in a deceitful manner?

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional and statutory provisions involved are set forth in the separately-bound Appendix beginning at page 1a. They include the following:

1. United States Constitution, Amendments V and VI.

2. United States Code, Title 15, Sections 78(i) and 78(j) (Securities Exchange Act §§ 9, 10).

3. Code of Federal Regulations, Title 17, Section 240.10b-5.

STATEMENT OF THE CASE

The indictment purports to charge a crime on the basis of alleged conduct "never heretofore branded improper by judicial decision, Commission rule or determination, or explicit Congressional act." (Concurring Opinion below, 55a.[1]) This alleged conduct consisted of guaranteeing three sellers of stock of Air West, Inc., ("Air West") against loss from sales on the American Stock Exchange. Allegedly these guarantees were given to induce directors of Air West to change their minds and accept an offer of Hughes Tool Company ("Hughes Tool") to purchase the assets of Air West, which the Air West shareholders

[1] References to page numbers of the separately-bound Appendix are in the format indicated in the text.

had approved but the directors had rejected by a narrow margin. (9a.) The alleged effect of the sales was to reduce the price of Air West stock on the American Stock Exchange on the date of the sales and to cause "the Air West stockholders who sold their stock in the declining market to receive the proceeds from their sales at artificially depressed prices." (10a.) The government has conceded that unless this alleged conduct violates Rule 10b-5 of the Commission, the indictment fails to state an offense. (33a.)

The indictment represents the second attempt to charge the petitioner, counsel for Hughes Tool, and the other defendants with a crime by reason of the alleged guarantee against losses. The District Court dismissed the earlier indictment as "the worst criminal pleading" it had ever encountered. (5a.) That indictment charged primarily that the guarantee against loss on the sale of the Air West stock constituted a manipulation of the market in violation of Section 9(a)(2) of the Exchange Act (15 U.S.C. § 78i (a)(2)). (27a-28a.) The government did not appeal from this dismissal. (*Id.*) Instead, it obtained a new indictment that does not charge a violation of Section 9(a)(2) nor does it allege, as did the first, that transactions in a security were effected on a national exchange "for the purpose of inducing the purchase or sale of such security", an essential element of the offense of market manipulation as defined by Congress.

Petitioner and other defendants moved to dismiss this second indictment for failure to state an offense. The prosecution concedes that there was nothing unlawful *per se* in guaranteeing a seller of securities against loss (5a) and that the sales were real, not

fictitious (26a). The indictment contains no suggestion that the sales were made in a deceptive manner, let alone in a manner that violated any specific rule of the Commission or at a price other than the price that obtained in a free market.

Because the indictment "alleges no false representation or half-truth or omission to state material facts made in connection with the purchase or sale of a security" (24a) and alleges no purpose to induce the purchase or sale of such security by others (22a), the District Court held that the conduct alleged did not violate any statute or regulation and dismissed the indictment.

The Court of Appeals reversed, solely on the basis of the general purpose of the Exchange Act to insure "fair and honest markets." Its opinion recognizes at the outset that "there has been very little litigation concerning the application of [Rule 10b-5] to market manipulation in corporate takeovers, and no case at all involving the specific conduct in which the appellees are alleged to have engaged." (36a.) In the absence of precedent, it turned to the legislative, administrative, and judicial history of the Exchange Act and Rule 10b-5 to determine whether the alleged conduct, if true, constituted an indictable offense. Reading Section 10(b) of the Exchange Act flexibly, not technically and restrictively, and Rule 10b-5 as a catch-all regulation operating independently of the statute, it held that market manipulation is a *per se* violation of Rule 10b-5 even if the "manipulation" does not contain the elements of market manipulation contained in Section 9(a)(2) of the Exchange Act and that the conduct alleged "falls within the type of activity which Con-

gress sought to prohibit in enacting the Securities Act and which Rule 10b-5 explicitly prohibits."

In a separate, concurring opinion, Judge Sneed:

(a) made clear that the court's decision was based upon its assertion of a residual power to outlaw conduct not proscribed by any statute, regulation, or decision, if that conduct offended the court's perception of a generalized underlying purpose of the securities laws (55a);

(b) recognized that the court was "eliminating *scienter*" from a criminal statute (57a);

(c) viewed the indictment as charging so-called "public welfare offenses" that "do not generally, and clearly not in this case, encounter the same demanding constitutional and interpretive standards applicable to other criminal offenses" (53a, 54a, 57a);

(d) conceded that the court's decision permits a prosecutor to indict on the basis of political considerations rather than legal standards (57a); and

(e) concluded that, although the law, as he read it, left him "no choice but to join my brothers," he found "no satisfaction or pleasure in doing so" (*id.*).

Nowhere in either opinion is there mention of this Court's decision in *Ernst & Ernst* v. *Hochfelder,* 96 S.Ct. 1375 (1976), which was decided after oral argument but prior to decision. Petitioner filed a petition for rehearing in which, *inter alia,* he pointed out the conflicts between the decision below and this Court's holding in *Hochfelder* that *scienter* is a necessary element of even a *civil* action under Rule 10b-5 and that Rule 10b-5 may not be used to nullify the carefully drawn restrictions of the statute as enacted by Congress. The court below denied the petition. It stated that it had considered *Hochfelder* but nonetheless deemed it advisable to explain and clarify the reasons for its conclusion. It concluded that its opinion was consistent with *Hochfelder,* citing the statement in its opinion "that it was necessary for the prosecutor to show an intentional act with 'a realization on the defendant's part that he was doing a wrongful act'" and the statement in the concurring opinion that "the intent necessary * * * is merely that of intending to do the acts prohibited, rather than intent to violate the statute." (60a.)

REASONS FOR GRANTING THE WRIT

On the basis of a claimed "residual power" to hold even in a criminal case that conduct is unlawful that does not violate the specific terms of any statute or regulation but rather offends against the general purpose of the Exchange Act, the Court of Appeals has reinstated the indictment against petitioner. Review by this Court is required because the decision does great violence to rights guaranteed under the Fifth and Sixth Amendments by the court's claimed residual power to subject petitioner to criminal prosecution for what neither he nor the grand jury that indicted him could know was a crime, and because (a) the decision disregards the teachings of this Court in *Hochfelder* that even in a civil action a court may not rely on a general purpose to create violations of the Exchange Act; (b) the court below has read out of the Act any requirement of *scienter* other than an intent

to do an act that a court later finds to be a violation of law, contrary to the holding in *Hochfelder* that an intent to deceive is an essential element of a Rule 10b-5 offense; (c) the holding of the court that "manipulation" is a *per se* violation of Rule 10b-5 is in direct conflict with the decision of the Sixth Circuit in *Marsh* v. *Armada Corporation,* 533 F.2d 978 (6th Cir. 1976), *petition for cert. pending,* No. 76-5; and (d) the court below has created a novel violation of the Exchange Act based on an intent to depress the price of a security without regard to whether a sale is a true sale or made in a manipulative manner.

The effect of the court's holding, as the concurring opinion below recognized, is to permit criminal indictment on the basis of no firmer a standard than which way a prosecutor determines the political winds are blowing, and to return to the case-by-case method of determining what is or is not a violation of the Exchange Act which this Court found to be an unjustifiable burden on the federal courts in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975).

A. Conflict with Hochfelder—The Need for Review with Respect to Statutory Limitations on the Scope of Rule 10b-5 Liability

The use of a catch-all rule to make unlawful on the basis of a general purpose of the Exchange Act what is not proscribed by statute or specific regulation does tremendous violence to due process of law. It subjects petitioner to criminal prosecution for an offense created by judicial fiat in the midst of a criminal case. This use of the purpose of the Act to create a violation is fundamentally at odds with this Court's decision in *Hochfelder.* The judicial creation of a violation of the

Act would not be permissible under *Hochfelder* even if this were a civil action.

The Exchange Act contains a precise definition of what is an unlawful manipulation. The opinion of the court below recognizes that an allegation that stock was sold for the purpose of inducing the purchase or sale of such stock by others is essential to the offense of market manipulation as defined in Section 9(a)(2) of the Exchange Act. Although the prosecution was well aware of this requirement from proceedings on a prior defective indictment, there is admittedly no such allegation in this indictment. The prosecution was unable to charge the offense proscribed by Congress.

The court below attempted to cure the defect by holding that the allegation required by Congress is unnecessary because Rule 10b-5 "operates independently" of the statute, and Section 9 of the statute "cannot be read as a limitation on Rule 10b-5". The court used the general language of Rule 10b-5 to exclude elements from the definition of unlawful market manipulation that Congress specifically included. But in *Hochfelder,* this Court rejected the contention that Rule 10b-5 could be "viewed in isolation" (96 S.Ct. at 1390). It stated that " 'the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen * * *.' " (*Id.* at 1397.) It held that the general language of Rule 10b-5 may not be used to nullify the express and carefully drawn restrictions of the statute. (*Id.* at 1389.)

For this reason, this Court in *Hochfelder* expressly rejected the same contention that the Court of Appeals uses as a justification for its decision. In *Hochfelder*

the SEC argued in terms almost identical to those used in the opinion below (compare 37a and 39a to 40a with 96. S.Ct. 1383-1384), that the broad remedial purposes of the statute permitted the Court to proscribe conduct not prohibited by the terms of the statute or rule. Rejecting the notion that a court could "draw on some unexpressed spirit outside the bounds" of the statute to outlaw an "effect" thought to contravene a general statutory purpose (96 S.Ct. at 1383 and 1384, n. 19), this Court held:

> * * * Rule 10b-5 was adopted pursuant to authority granted the Commission under § 10(b). The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is "the power to adopt regulations to carry into effect the will of Congress as expressed by the statute." * * * Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b). [96 S.Ct. at 1390-1391.]

The holding of the court below that Section 9 of the Exchange Act is not a limitation on Rule 10b-5 is flatly contrary to *Hochfelder*. By ignoring this Court's teaching in *Hochfelder,* the court below created a crime that was of its own making, not that of Congress. The rationale of *Hochfelder* has special force in this criminal prosecution, where it cannot be overlooked that "legislatures and not the courts should define criminal activity." *United States* v. *Bass,* 404 U.S. 336, 348 (1971), and where due process requires that fair warning be given, "plainly and unmistakably," that particular conduct is a crime. *Id.*

The decision below invites exactly the kind of "endless case by case" determinations, under no set standard other than whether the facts alleged constitute conduct that in the court's view violates a general purpose, that this Court found to be an unjustifiable burden on the federal courts in *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 755. Moreover, like the Ninth Circuit decision reversed in *Blue Chips,* the lack of any standard makes it all but impossible to weed out, prior to trial, those cases that justify the burden and expense of protracted litigation from those that do not. *Id.* at 739-743. And the lure of appellate review is all but irresistible because one judge's perception of what offends a generalized purpose may well differ from another's. For these reasons as well, an early and definitive decision is necessary to set to rest, once and for all, the troublesome and recurring question as to the substantive reach of Rule 10b-5 and to apply the principles announced in *Hochfelder* to that question.

B. Conflict between the Circuits: Manipulation as a per se Violation of Rule 10b-5

The fundamental defect that permeates the entire opinion of the Ninth Circuit is its failure to correlate the conduct charged in the indictment with the terms of the statute and rule alleged to have been violated. The court below states that clauses (a) and (c) of Rule 10b-5 are a "flat prohibition" against "market manipulations." (41a.) But neither clause (a) nor clause (c) of Rule 10b-5 mentions "market manipulations" and the flat prohibition, as the concurring opinion below recognized, is not to be found in the Rule. (55a.[2])

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[2] Clauses (a) and (c) of Rule 10b-5 make it unlawful, in connection with the purchase or sale of a security, (a) "to employ

The holding of the Ninth Circuit that Rule 10b-5 contains a flat prohibition against market manipulation conflicts with the decision of the Sixth Circuit in *Marsh* v. *Armada Corporation, supra,* now pending in this Court, No. 76-5. That case was decided after oral argument in the court below but prior to the issuance of the court's opinion and was cited to the court in the petition for rehearing. In that case, the Court of Appeals for the Sixth Circuit held that Section 10(b) and Rule 10b-5 do "not flatly prohibit the use of a manipulative device" but rather prohibit only such conduct as, upon analysis, constitutes unlawful deception within the terms of Rule 10b-5. *Marsh* v. *Armada Corporation, supra,* 533 F.2d at 983.

In the *Marsh* case, the Sixth Circuit properly analyzed the conduct at issue so as to ascertain whether it involved unlawful deception. In sharp contrast, the opinion of the Ninth Circuit ignores the specific terms of the statute and rule alleged to have been violated and by so doing, in this case, creates a crime in a statutory vacuum of its own making. Quite apart from the violence that this judicial creation of a crime does to petitioner's Fifth and Sixth Amendment rights, review by this Court is required to resolve this conflict between the circuits on this important issue as to the proper application of the securities laws.

C. A Second Departure from Hochfelder: Scienter

One would have thought that this Court's opinion in *Hochfelder* settled with finality the necessity of a

any device, scheme, or artifice to defraud" and (c) "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person • • •."

specific intent to deceive or defraud, at least in a private action under Rule 10b-5. And if that intent is required in a private civil action, then, *a fortiori,* it is a necessary element in a criminal prosecution under the same rule. Nevertheless, the court below decided that Rule 10b-5 requires no specific intent to deceive or defraud and holds that it is sufficient if there is some ill-defined generalized intent to do the act that the court finds violates the rule.[3]

It is impossible to find in the indictment who it was that petitioner allegedly intended to deceive or defraud in connection with the purchase or sale of a security. The government claims the objects of the deceit were those who sold their Air West stock when the market price declined. (17a.) The claim is ridiculous. The indictment carefully omits the charge that the sales were made for the purpose of inducing sales by others and thus negates the existence of an intent to defraud or deceive those who may have sold their stock at an allegedly depressed price.

The concurring opinion frankly recognized that the court was reading *scienter* out of a criminal statute. It explained what the court was doing by reference to "public welfare offenses" as defined in *Morissette* v. *United States,* 342 U.S. 246 (1952). But *Morissette* only shows the error of the decision below, for there the

[3] The court below thought that "precedents established in civil cases interpreting Rule 10b-5 are applicable in criminal prosecutions under the Rule, as here." (38a.) Certainly the restrictions on use of the rule in civil cases apply at least as strongly in a criminal prosecution. But there is good reason to think that an even more restrictive approach must be taken in a criminal case than in a civil action. *See SEC* v. *Capital Gains Research Bureau,* 375 U.S. 180, 183 n. 40 (1963).

defendant was convicted of stealing government property on the basis of an instruction that "[t]he question on intent is whether or not he intended to take the property" (342 U.S. at 249), and this Court reversed because the proper question was whether the defendant intended to steal. (*Id.* at 276.) The Court distinguished cases of relatively minor offenses, punishable by a fine, in which a statute proscribes a particular result, as for example, the selling of adulterated milk, without regard to whether the result caused or was intended to cause direct injury to person or property. (342 U.S. at 252, 256.) A violation of the Exchange Act is not a minor crime. It is a felony. Besides, this Court held in *Hochfelder* that *scienter* was an essential element of Rule 10b-5, and thus "public welfare offenses" have as little relevance to determining whether this indictment charges a crime as they do as justification for applying in this case some lesser constitutional standard other than that applicable to other serious crimes.

The treatment of *scienter* by the Court of Appeals requires review by this Court to settle once and for all whether a specific intent to deceive or defraud is required under Rule 10b-5. A recent memorandum from the SEC General Counsel to staff attorneys illustrates the practical consequences that would follow if this Court's holding in *Hochfelder* were eroded in the manner reflected in the decision of the Court of Appeals.[4] The SEC memorandum advises staff attorneys to avoid allegations of *scienter* in future pleadings except in cases where the staff has evidence that would support the allegations required by this Court. (BNA, Sec. Reg. L. Rep. No. 354 at F-3 (May 26, 1976).) This tactic,

[4] The memorandum was published by the Bureau of National Affairs, Sec. Reg. L. Rep. No. 354 at F-1 (May 26, 1976).

says the SEC General Counsel, "will provide the staff with flexibility in proving its case." (*Id.*)

The lower courts should not be burdened with time-consuming "flexibility of proof" under pleadings calculated to find a form of words that circumvents this Court's requirement of an allegation of intent to deceive. There is no room in *Hochfelder,* particularly as applied to a criminal prosecution, for the kind of "flexibility" sought by the SEC memorandum and reflected in the decision of the Court of Appeals. There is an urgent need that this Court make clear that the decision in *Hochfelder* may not be circumvented by artful pleading or sophistic distinctions that cloak the absence of an essential element of a statutory offense.

D. The Use of Rule 10b-5 to Supply a Missing Element: The Creation of a Crime by Judicial Fiat

Until this case, no court has held that market manipulation in violation of the Exchange Act may be accomplished by selling stock on a national exchange in accordance with the rules of the Commission and the Exchange, in real, not fictitious, sales and without any deceptive practice.

According to the Court of Appeals, the conduct at issue is "certain guarantees against trading losses." (28a.) But neither the court nor the government ever questioned the soundness of the government's admission in the District Court that a guarantee against loss on the sale of stock is perfectly lawful in itself. (5a) Indeed, the Court of Appeals recognized that if the sales had the "incidental effect" of depressing the market price of the stock, the guarantees would retain their lawful character. (44a.)

The only identification of what the Court of Appeals regards as distinguishing the lawful from the unlawful is its statement that

> * * * the appellees are not charged with trading activities which had the effect of changing market prices (as might any large scale transactions). Rather, appellees are charged with deliberately depressing market prices—a different matter entirely from incidentally depressing prices through trading activities. [44a.]

Why it is a different matter the court below never explains. Deliberately depressing market prices, instead of incidentally depressing market prices, is a crime because the court says it is.

The conclusion is startling. Suppose that a rich man who fervently believes that all men are created equal owns a sizable bloc of stock in a corporation that has large interests in South Africa. Suppose that because of his opposition to apartheid he sells this stock with every intention in the world of depressing the price of the stock and thus convincing the Board of Directors of the corporation to stop doing business in South Africa. Suppose he goes further and persuades his friends to sell stock for the same purpose, guaranteeing them against loss. According to the opinion of the court below, he has committed a crime, not because the statute says so but because the court says so. Petitioner here, who never sold any Air West stock, can be convicted under like instructions to the jury.

This conclusion that selling stock for the purpose of depressing the price is a crime becomes even more startling if one looks at the legislative history of the Exchange Act. The court below purported to use legislative

history as a guide but ignored the most important part of that history. The original bills considered by the House and Senate *did* proscribe trades on a national securities exchange "when they are made for the purpose of raising or depressing the market price." H. Rep. No. 1383, 73d Cong., 2d Sess. 18 (1934); S. Rep. No. 792, 73d Cong., 2d Sess. 17 (1934). But after an industry representative pointed out that this provision gave "no means by which the average citizen can tell when he is going to fall within the scope of the criminal provision or not,"[5] the bill was amended to provide that the statute could not be violated unless the transaction was entered into "for the purpose of inducing the purchase or sale of such security by others." Now the provision that Congress rejected has become the head and cornerstone of a new crime created not by Congress or even by Commission rule, but by the court below.

There is no warrant in the language of the statute or the rule that permits this remarkable result. The court's statement that clauses (a) and (c) of Rule 10b-5 prohibit "manipulative activities *per se*" overlooks that these clauses do no such thing and overlooks to boot that Rule 10b-5 is a proscription against fraud. *Marsh* v. *Armada Corporation, supra,* 533 F.2d at 983.

Where is the fraud? According to the court it is in "the manipulation." What is a "manipulation"? The court gives no answer.

How could there be a manipulation when stock is sold in real transactions in accordance with the rules

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[5] *Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 Before the Senate Banking and Currency Committee,* 73d Cong. 6510 (1934).

and regulations both of the Commission and the Exchange? The court is silent.

There is no need for these mysteries. In *Ernst & Ernst* v. *Hochfelder,* 96 S.Ct. at 1384, this Court pointed out that manipulation "is and was virtually a term of art when used in connection with securities markets", quoting the dictionary definition of "manipulate" as follows:

> "To force [prices] up or down, as by matched orders, wash sales, fictitious reports * * *; to rig." [*Id.* at n. 21.]

To manipulate is thus not to force prices up or down, but to do so by particular means that are deceptive. That is why Section 9(a)(2) of the Exchange Act does not make it unlawful to raise or depress the price but requires that stock be sold for a particular unlawful purpose and in a manner calculated to achieve the purpose. The Court of Appeals committed fundamental error when it asserted that it is a criminal manipulation to depress the price, however deliberately, without regard to the means by which the depression in price is accomplished.

As applied to sales of stock, the term of art, "manipulation", proscribes a particular manner or means of selling, not the motive of the seller. Each of the particular means referred to in the definition quoted in *Hochfelder* is manipulative not because it raises or depresses price, but because of the way in which it does so. All three means give the appearance that a sale has taken place when, in fact, it has not. But here the government has conceded that the sales of stock involved were

true sales to independent buyers. (26a.) Unlike wash sales and matched orders, the sales were not artificial.[6]

Nor is anything alleged in the indictment or stated in the Court of Appeals opinion that would permit the conclusion that the sales were made in a deceptive or artificial manner. It is not contended that the stock was offered for sale at any price other than that at which independent buyers were offering to buy. Nor is it claimed that there was any collusion among brokers or that the sales were made in any manner other than that in which sales are ordinarily made on the Exchange.

As with the postulated sales for the purpose of inducing the directors of a corporation to change their mind about doing business in South Africa, the sales alleged in this indictment may have depressed the price and may be assumed, for purposes of argument, to have been intended to do so. But they were true sales, lawfully executed. There is no statute or regulation that makes such sales unlawful.

The Court of Appeals in effect concedes as much, but asserts that the judicial function in construing Rule 10b-5 is to outlaw whatever "effects" the court regards as contravening the underlying purpose of the securi-

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[6] The true sales of stock involved here are also fundamentally different from the transaction involved in *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970), relied on by the Court of Appeals. In *Crane* an apparent purchaser of stock on the market was financing its purchases with the proceeds of secret sales of the same stock off the market, and thus did not actually acquire ownership of the stock apparently purchased. Here, it is conceded that the sellers divested themselves of ownership of the stock they in fact sold. Therefore, these were true sales, not as in *Crane* sham purchases and sales.

ties laws, without regard to the terms of the Rule or of related and interdependent provisions of the Exchange Act. As shown above, this assertion is directly contrary to the principles of construction this Court articulated and applied in the *Hochfelder* case.

The ignoring of the Court's teaching in *Hochfelder* is the source of the complete confusion as to the application of Rule 10b-5 that the opinion of the Court of Appeals will necessarily engender in bench, bar, and citizenry.

E. The Creation of a Crime by Judicial Fiat: A Denial of Constitutional Rights

By departing from the principles set forth in *Hochfelder,* the Court of Appeals unnecessarily created the concerns candidly expressed in Judge Sneed's concurring opinion. If this were a civil action, then the decision below would represent only a departure from principles that this Court has established. But the decision was rendered in a criminal proceeding and results in the deprivation of fundamental rights.

Due process mandates that no person shall be held criminally responsible for conduct which he could not reasonably understand to be proscribed. *Jordan* v. *DeGeorge,* 341 U.S. 233 (1951). Here, as the concurring opinion below concedes, the court found a criminal violation in conduct "never heretofore branded improper by judicial decision, Commission rule or determination, or explicit Congressional act." (55a.)

Due process mandates that a criminal statute must provide some reasonable standard of guilt. Here the only standard is the court's perception of a generalized purpose. Gone are the requirements "to give adequate

guidance to those who would be law-abiding, to advise defendants of the nature of the offense with which they are charged, [and] to guide courts in trying those who are accused." *Musser* v. *Utah,* 333 U.S. 95, 97 (1948).

Due process mandates that a crime be created by Congress, not by an appellate court's use of a claimed residual power to declare conduct unlawful through an "expansive" reading of a "catch-all" regulation. *United States* v. *Bass, supra,* 404 U.S. at 348.

Due process mandates that one charged with a crime know what are the elements of the crime so that he can prepare his defense. Even today petitioner can have no firm idea of what the government claims he did that was unlawful. The court below, having created a new crime, never defines it.[7]

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[7] The confusion engendered by the opinion of the Court of Appeals as to the application of Rule 10b-5 is nowhere more apparent than in its discussion of a purported violation consisting of a failure of disclosure. (44a-45a.) This discussion appears in a section of the court's opinion entitled "Validity of the Indictment", which follows the section entitled "Rule 10b-5 and Market Manipulation". The court states that "our reading of Counts I and II persuade [sic] us" that the indictment does allege a failure to disclose. The fact is that there is no allegation whatsoever in the indictment that the defendants failed to disclose anything to anyone.

Proceeding on the unsupported factual premise that the indictment alleges a failure to disclose, the Court of Appeals says that the expression of an opinion that the price of Air West stock would decline "without revealing that the decline was not due to the free operation of market forces" is a violation of Rule 10b-5.

The Court of Appeals appears to be creating a new duty of affirmative disclosure—without indicating to whom, when, and in what manner the disclosure must be made—whenever anyone engages in conduct that could affect the market price of a security. Whatever the propriety of creating such a duty on the basis of an indictment that does not allege the breach of any duty of disclosure, the imposition of this duty is flatly contrary to this Court's

The Fifth Amendment requires indictment by a grand jury. The decision of the court makes meaningless this "basic guarantee of individual liberty", *United States* v. *Mandujano,* 96 S.Ct. 1768, 1774 (1976), as well as the correlative Sixth Amendment right of a defendant to know the nature of the accusation against him. *See Russell* v. *United States,* 369 U.S. 749 (1962). The grand jury that indicted petitioner could not possibly have understood the elements of the crime for which it indicted him—and certainly the District Court could not find them—since those elements were ultimately found in the appellate court's perception of a general statutory purpose.

No wonder Judge Sneed warned that, on the basis of the court's opinion, the decision to prosecute or not to prosecute "is likely to be one in keeping with the political realities within which [the prosecutor] functions." Judge Sneed termed this part of the price that "this type of statute compels us to pay". But it is the decision of the court, not the statute, that would exact this price—a price that, we submit, is too high in terms of basic rights to be permissible.

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holding in *TSC Industries, Inc.* v. *Northway, Inc.*, 96 S.Ct. 2126 (1976).

CONCLUSION

For the reasons stated herein, this writ should be granted and the judgment of the Court of Appeals for the Ninth Circuit reversed.

Respectfully submitted,

CHARLES ALAN WRIGHT
2500 Red River
Austin, Texas 78712

MOSES LASKY
BROBECK, PHLEGER & HARRISON
111 Sutter Street
San Francisco, California 94104

E. BARRETT PRETTYMAN, JR.
SHERWIN J. MARKMAN
JOSEPH M. HASSETT
HOGAN & HARTSON
815 Connecticut Avenue, N.W.
Washington, D.C. 20006

MAXWELL E. COX
DAVIS & COX
One State Street Plaza
New York, New York 10004

Attorneys for Petitioner